Supreme Court, U.S.
FILED

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OFFICE OF THE CLERK

In The
Supreme Court of the United States

Darlow Thomas Madge,

Petitioner,

v.

Commissioner, Internal Revenue,

Respondent.

On Petition for Writ of Certiorari
To the United States Court of Appeals
for the Eighth Circuit

PETITION FOR WRIT OF CERTIORARI

Darlow Thomas Madge
In propria persona
1405 Lille Court
Franklin, TN 37067
(615) 591-1645

P8034

QUESTIONS PRESENTED FOR REVIEW

1. Did the Court of Appeals err in failing to recognize the novelty of Appellant's argument of law, which received neither consideration nor judgment on its merits?

2. Did the Court of Appeals err in denying Appellant's Motion to take Judicial Notice based on new evidence in the form of his year 2000 tax return demonstrating that Appellee Commissioner of Internal Revenue has accepted Appellant's argument of law?

3. Did the Court of Appeals err in finding that Appellant's argument is frivolous, because the issues raised in this appeal have not been decided in any previous cases and because the IRS has accepted the same argument as presented in Appellant's year 2000 tax return and issued a credit to Appellant for the full amount requested?

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PETITION FOR WRIT OF CERTIORARI

Petitioner, Darlow Thomas Madge ("Petitioner") requests that a writ of certiorarii issue to review the judgment of the United States Court of Appeals For The Eighth Circuit in *Darlow T. Madge v. Commissioner of Internal Revenue,* Docket No. 01-1531, UNPUBLISHED Opinion dated November 14, 2001, and Order Denying Petition for Rehearing and for Rehearing En Banc, Dated January 23, 2002.

CITATIONS TO OPINIONS BELOW

The opinion of the United States Court of Appeals For The Eighth Circuit affirming the judgement of the United States Tax Court, Chicago, Illinois, dated December 7, 2000, is UNPUBLISHED and is set forth in Appendix 1.

JURISDICTION

Jurisdiction over this case is conferred upon the Supreme Court of the United States by 28 U.S.C. §1254, as an appeal from a final judgment of the United States Court of Appeals, which denied Appellant's petition for rehearing en banc on January 23, 2002 after a panel of that Court issued a judgment on November 14, 2001 affirming an opinion of the Tax Court.

CONSTITUTIONAL AND STATUTORY PROVISIONS

This case involves Title 26 U.S.C. Sections 1, 61, and 861, and their implementing regulations setting forth a specific and novel argument of law pertaining to sources of gross income which show Petitioner's income to be "exempt income". This case involves the use and application of the word "source" as reflected in the statutes and treasury regulations..."from whatever source derived" to have a defined meaning.

STATEMENT OF THE CASE

Appellant did not file federal income tax returns or make any estimated tax payments for the years 1987 through 1993. In March 1994 Special Agent Darryl Williams of the Internal Revenue Service's Criminal Investigation Division (CID) executed a search warrant at Appellant's home. During the execution of the warrant, Agent Williams took into possession a ledger book that contained information on accounts receivable and accounts payable for Appellant's business Allied Medical Associates for the years 1987 through 1993. In addition to the information in the ledger book, CID discovered further information regarding Appellant's assets from contacting the various banks at which Appellant maintained accounts for himself and for his business.

Based on all of this information, Appellant was indicted in 1997 for four counts of tax evasion for tax years 1990, 1991, 1992 and 1993 for violations of 26 U.S.C. §7201 and one count of conspiracy to obstruct and impede the IRS in violation of 18 U.S.C. §371. Appellant testified in his own defense, and the prosecution did not ask any questions regarding the numbers contained in Appellant's records. Appellant was found guilty on all five counts and was sentenced to 41 months imprisonment.

At no time during the trial were any findings of fact made by the judge or jury regarding the tax liabilities of Appellant; rather, the jury's verdict, and the judge's sentence, referred exclusively to Appellant's acts of evasion.

While Appellant was serving his sentence for evasion, Appellee issued a Notice of Deficiency against Appellant for the seven years in question, 1987-1993. At no time before the determination of deficiency

or since then did Appellee ever explain to Appellant his rights before the agency in civil administrative proceedings, nor did Appellee ever provide Appellant with any of his rights therein. Those rights include the right to be notified of an examination hearing and the right to be present at such hearing, the right to make contentions of fact, the right to cross-examine adverse testimony and witnesses, the right to present witnesses and testimony, and the right to be notified of the proper appeals process and to be provided with a complete appeals process before the Internal Revenue Service. Instead, the IRS gave false information to Appellant, informing him that his only recourse for appealing the *ex parte* decision of the agency was to file a petition in United States Tax Court.

At trial, during dispensation of preliminary matters, Tax Court stated as a matter of law that Appellant's legal arguments were frivolous and that if he continued to pursue them at trial that a penalty would be imposed against him (Lodging #1 - Transcript 3). However, the Judge never cited any case law that addressed the legal issues which Appellant raised, and it appears as though there is no case law on the issues that Appellant is raising.

The Tax Court Judge stated that insofar as there is a determination of fraudulent intent, Appellant is collaterally estopped from raising the issue for the years for which he was convicted under 26 U.S.C. 7201 (Transcript 3-4). Appellant does not dispute such a narrowly tailored application of collateral estoppel. However, the Judge effectively expanded the concept of collateral estoppel in such an erroneous manner that it appears to have encompassed any kind of a challenge to the documents and testimony offered as evidence against Appellant in this instant matter. Such an improper blockade appears on page 49 of the Transcript: when Appellant asked about the sources of

income (a proper question under the statutes and regulations), the Judge made the inappropriate and inopportune statement: "I'm not going to waste time arguing with you. You went to prison over this."

Appellee called two witnesses, CID Agent Williams and IRS Examiner Matthew Wagner (testifying under a false name). Under direct examination, Agent Williams testified that he was the agent who seized Appellant's books and records, and Mr. Wagner testified that he was the Examiner who examined Appellant's records and made the determination upon which the deficiencies, additions to tax and penalties were based.

On cross-examination, Mr. Wagner admitted that he does not have a strong understanding of the Internal Revenue Laws. In particular, Mr. Wagner could not cite the provision of law which empowered him with authority to make these determinations (Transcript 79-80), nor could he even recite the one-line defintion of the term "gross income" until he was provided with a copy of the Internal Revenue Code from which to read (Transcript 82).

Appellant attempted to further impeach the credibility of the witness by introducing a line of questions to determine how Mr. Wagner was able to make legal determinations of what constituted "gross income" if he lacked even a rudimentary understanding of what the term "gross income" means. However, before Appellant could ask an impeaching question of the witness, the Tax Court judge interrupted Appellant even without an objection by Appellee and refused to allow Appellant to continue on a line of questioning which would lead to impeaching the credibility of the witness (Transcript 83).

Furthermore, Appellant asked permission to pursue a line of questioning that would explore whether Mr. Wagner, the examiner who made the initial determination of deficiency, provided due process of law to Appellant as is required by law. The Tax Court Judge denied him permission to question the witness about whether the witness violated the law in making the determination of tax; and in addition, the Judge stated that it was necessary to provide Appellant with due process at an Examination Hearing because, as the Judge stated, "You're just showing how futile that right would have been if you had it."

Finally, the Tax Court issued a ruling of fact from the bench that Appellant's income is "from whatever source derived" as defined by 26 U.S.C. 61, even though the word "source" is given great and specific legal, statutory, and legislative significance within the Internal Revenue Code and implementing Regulations of the Secretary of the Treasury. This ruling did not take into account the legal requirements and authorities surrounding the word "source", or the definitions subjugating that term to any number of exclusions as provided in subtitle A of the Internal Revenue Code.

Upon issuance of judgment against him, Appellant appealed his case to the United States Court of Appeals for the Eighth Circuit. Before filing his opening brief, Appellant filed his year 2000 tax return with the Internal Revenue Service seeking a refund for all taxes paid through employer withholdings (Lodging #2). Subsequent to filing his opening brief but before Appellee filed its response brief, Appellant received a response from the IRS stating that a credit for the full amount requested by Appellant would be issued and that the credit would be applied to tax deficiencies for other years (Lodging #3).

Appellee's response brief before the Eighth Circuit repeated the claims that Appellant was positing frivolous arguments. Appellant then submitted his reply brief and a Motion to Take Judicial Notice of new evidence, namely the tax return and the IRS refund-credit. Appellant had no opportunity to present such evidence to the trial court since the evidence was not available at that time; and such evidence has clear bearing on the merits of this case.

The Court of Appeals denied the Motion to Take Judicial Notice without explanation, and affirmed the judgment of the Tax Court in a two-paragraph opinion that focused largely on the fact that Appellant had been convicted of felony charges in a separate proceeding. Little was said about the issues presented in the briefs before that Court as well.

Appellant was railroaded at trial in the Tax Court, on the basis that he was convicted of criminal tax evasion prior to the commencement of this case. Though certain issues were not retried on the basis of *res judicata*, as such issues had been adjudicated in his criminal trial, the Tax Court denied Appellant a fair opportunity to present his case and to question witnesses. On appeal to the United States Court of Appeals for the Eighth Circuit, Appellant presented not only legal briefs explaining his argument of law but also new evidence which arose during the appellate stage. The Court of Appeals refused to grant Appellant's Motion to Take Judicial Notice, even though the evidence that Appellant sought to admit served the interests of justice and was unavailable at trial. Such evidence would have provided proof that Appellee agrees with Appellant's legal position while it argued to the contrary in the courts. For these reasons, Appellant could not have made frivolous arguments in the courts.

REASONS FOR GRANTING THE WRIT

1. THE COURT OF APPEALS ERRED IN FAILING TO RECOGNIZE THE NOVELTY OF APPELLANT'S ARGUMENT OF LAW WHICH RECEIVED NEITHER CONSIDERATION NOR JUDGMENT ON ITS MERITS

When Appellant argued his case before the Tax Court, he made specific arguments of law which were novel and worthy of consideration; but the Tax Court opinion made no mention of the arguments actually presented. In its briefs before the Court of Appeals, Appellant reiterated and further elucidated those arguments in such a manner that this Court would understand that this novel argument required a decision on its merits.

Yet in its two-paragraph order affirming the Tax Court judgment, a panel of the Eighth Circuit Court ruled that Appellant was presenting arguments that "the income from his business was not 'gross income' under 26 U.S.C. §61(a)." Such a statement does no justice to the pains Appellant took to explain his argument of law so meticulously, for the Court's judgment implies that Appellant argued nothing more than this solitary statement. For the sake of consistency, Appellant restates his legal position.

Appellant attempted to prove that the deficiencies that Appellee assessed were incorrect on the basis that Appellee did not take into account what was the "source" of the income. The Tax Court judge incorrectly stopped Appellant's questioning of Examiner Wagner, and in so doing made a legal determination that the source of the income is irrelevant. However, such a decision by the judge is inconsistent with

26 U.S.C. §§861-863 and the supporting regulations of the Secretary of the Treasury and this Court's acknowledgement of the source determination requirements as set forth in *James v. United States*, 366 U.S. 213, 248 (1961) and *United States v. Burke*, 504 U.S. 229 (1992). Since the Legislative and Executive branches have given specialized meaning to the word "source" in the statutes and regulations, and this Court has already acknowledged same, the courts in this instant matter should have looked solely to the plain meaning of the statutes and regulations. *See, e.g., Demarest v. Manspeaker*, 498 U.S. 184 (1991); *Connecticut National Bank v. Germain*, 503 U.S. 249 (1992).

As 26 U.S.C. §61 clearly states, gross income is defined as "all income from whatever *source* derived, including (but not limited to, the following *items*..." (emphasis added). Even without reading any further into the statutes, it should be clear from the usage of the words that "source" and "item" do not mean the same thing; for "source" refers to the place from where the income came and "item" is a mere component of gross income and refers to the form in which the income is received. *See* Richard Westin, LEXICON OF TAX TERMINOLOGY 383, 719.

In keeping with the statutory language of 26 U.S.C. §61(a), which states that "Except as otherwise provided in this subtitle...", 26 C.F.R. §1.61(a) provides further detail as to the meaning of gross income. First, the definition of gross income is given as "all income from whatever source derived, unless excluded by law." It also states that "Section 61 lists the more common items of gross income for purposes of illustration." This section of regulation clearly demonstrates that the "item" is far less relevant to determining gross income than is the "source", and also admits that this section recognizes that some income is excluded from gross income.

In the regulations governing the statute governing income within the United States, 26 C.F.R. §1.861-8(f)(3)(ii) states: "Sections 861, 862, 863(a), and 863(b) are the four provisions applicable in determining taxable income from specific sources." This language is clearly *exclusive* (as opposed to the "inclusive" language as seen in 26 U.S.C. §61); and if nothing else, this language clearly demonstrates that determination of the source of income is of the greatest importance when determining income which is taxable in relationship to U.S. Sources. Only §861 deals with sources within the United States; §§862-863 deal with sources without the United States.

26 C.F.R. §1.861-8 describes the "Computation of taxable income from sources within the United States and from other sources and activities". The rule at 26 C.F.R. 1.861-8(a)(4) sets forth the source determination process, and in so doing refers to 26 C.F.R. §1.861-8(f)(1), which reads: "The operative sections of the Code which require the determination of taxable income of the taxpayer from specific sources or activities and which give rise to statutory groupings to which this section is applicable include the sections described below." None of these subsections of 26 C.F.R. §1.861-8(f)(1), which communicate the specific U.S. sources, apply to Appellant, and pursuant to 26 C.F.R. §1.861-8(a)(4) sources not listed are called residual groupings that may be made up entirely of "excluded income". Furthermore, 26 C.F.R. §1.861-8T(d)(2)(ii)(A) states: "For purposes of this section, the term "exempt income" means any income that is, in whole or in part, exempt, *excluded*, or eliminated for federal income tax purposes" (emphasis added).

Though 26 U.S.C. §861 does apply to Appellant because the remuneration that was deemed to be his was from within the U.S., nevertheless his income is excluded from all of the specific sources

under 26 C.F.R. §1.861-8(f)(1), as set forth in 26 C.F.R. §1.861-8(a)(4) and is therefore within the definition of "exempt income" per 26 C.F.R. §1.861-8T(d)(2)(ii)(A). None of the provisions by the Secretary for determining the U.S. sources of taxable income apply to Appellant and thus the rules at §1.861-8(a)(4) regarding residual groupings do apply. Therefore, finding no other rules regarding U.S. Sources under the Internal Revenue Code and Treasury Regulations, Appellant has no gross income or taxable income.

Though such a reading of the law might certainly lack customary acceptance or be unpopular, there is clear foundation for it within the words of standing law, and it is certainly logical and valid within the rules of federal statutory construction, which require every word of the statutes and regulations be given effect by the Courts. And until such an argument is addressed by the courts, all persons with U.S. Source income must read the law and the regulations as well as apply them, and arguments that stem from application of standing law cannot be considered frivolous. However, even if Appellant's income does qualify as "gross income", the initial burden of production rests with Appellee to demonstrate that they obeyed the law and made a proper determination of the source of income.

Nevertheless, in this case the Tax Court disregarded the rule of statutory construction that when two or more statutes are capable of co-existence that both are to be regarded as effective. *See Morton v Mancari*, 417 U.S. 535, 551 (1974). Instead, the Tax Court determined that the source of income is an irrelevant issue of fact, and therefore permitted no evidence to be entered regarding the issue. The reasoning above shows that the judge's ruling was clearly erroneous as a matter of law, as the judge's interpretation of the law served the purpose of

rendering superfluous the specific language of Congress and the Secretary of the Treasury.

In the Court of Appeals' opinion affirming the Tax Court's judgment, there is no treatment at all concerning these legal issues. Appellant admits that his prior criminal conviction for fraud has relevance in this case, but it certainly cannot be the only factor since determination of Appellant's gross income was never part of the proceedings during Appellant's criminal trial. Otherwise the matter of specific liability would have been *res judicata* and no administrative process would have been implemented. It is easily possible to be found guilty of tax evasion without having any monetary gain at all by committing actions which would appear to a jury to be fraudulent acts, yet if evidence of gross income and witnesses of same were not presented in such proceedings for adjudication claims of such cannot be deemed *res judicata*. Therefore, the Commissioner of Internal Revenue, per 26 C.F.R. §601.105(b)(2)(ii), and the Courts as so charged, must look at the income itself and determine whether such income meets the legal definition of "gross income" as defined not only in 26 U.S.C. §61(a), but also by its statutory precursors and the Treasury Regulations (*United States v. Burke*, 504 U.S. 229 (1992) as well as make mindful consideration of arguments of same.

II. THE COURT OF APPEALS ERRED IN DENYING APPELLANT'S MOTION TO TAKE JUDICIAL NOTICE BASED ON NEW EVIDENCE IN THE FORM OF HIS YEAR 2000 TAX RETURN DEMONSTRATING THAT APPELLEE HAS ACCEPTED APPELLANT'S ARGUMENT OF LAW

Appellant understands that it is highly irregular to introduce new evidence at the appellate stage of a proceeding. However, the evidence came to light significantly after the Tax Court trial and even after Appellant filed his initial brief with the Court of Appeals. For this reason, it was proper for the Court of Appeals to grant Appellant's Motion to Take Judicial Notice of the new evidence, and the failure by the Court of Appeals to do so was clear error that resulted in significant harm to Appellant's ability to present his case.

On March 12, 2001 Appellant filed a timely tax return. This return consisted of a set of forms including Form 1040, Forms 4852 and Form 8275. On Form 1040 Appellant declared his gross income to be zero dollars and that a refund is due him on overpaid taxes in the amount of $398.19. Two Forms 4852 were used to declare incorrect and challenge reports of Appellant's gross income by third-party payors issuing W-2 forms to the IRS, and a Form 8275 was used to explain how the position taken on the tax return is completely consistent with the legal position of the Secretary of the Treasury as set forth in the regulations. The legal position taken on Appellant's tax return for year 2000 is no different than the argument which Appellant has presented before the Tax Court and the Court of Appeals for years 1987-1993.

On April 16, 2001, the IRS sent a letter to Appellant stating that Appellant's tax return has been received and reviewed and that Appellant would receive a credit in the amount of $398.19. Essentially, the IRS accepted Appellant's argument as legal and valid, and in light of the extensive volume of law and regulations supporting him, there is no reason to believe that Appellant's claim and refund were anything but correct.

Appellant understands that the IRS has many thousands of employees and that it is likely that the examiner who approved Appellant's return may not be the same examiner who reviewed his 1987-1993 records and testified in the Tax Court trial. However, it is certain that the IRS examiner who reviewed the year 2000 tax return did so only because that examiner believed in earnest that the return was factually truthful and legally accurate. Furthermore, that examiner had access to previous records in Appellant's file, including the status of this case, and it is unlikely that the examiner approved the credit to Appellant's account without taking some notice of the previous records. The most convincing evidence that this was no mistake by the IRS is that the IRS is clearly on notice that they accepted Appellant's arguments based on this case, and there have to date been no attempts by the IRS to pursue a proper and procedurally correct claim against Appellant to reclaim the mistaken credit.

While these events were occurring at the administrative level, counsel for Appellee told this Court that there is no reasonable grounds for Appellant's legal position. Appellant acknowledges that counsel for Appellee probably was unaware of the results of the review of Appellant's year 2000 tax return. However, the IRS acceptance of the validity of Appellant's year 2000 tax return is clear and convincing evidence that the IRS understands fully that the discussion of what constitutes gross income does not end at Section 61 and *Commissioner v. Glenshaw Glass*, 348 U.S. 426 (1955), and that Appellant's legal position is not frivolous.

Before the Court of Appeals, Appellee argued to this Court that such evidence would be irrelevant to this proceeding and therefore the Motion to Take Judicial Notice should be denied. However, such evidence is of the highest relevance here. Though the year 2000 is not

in question, the applicable law and legal arguments are the same on the year 2000 return as presented in this case concerning years 1987-1993; and it is precisely the congruence of arguments and law which make the year 2000 return highly relevant.

Relevant evidence that would have greatly aided Appellant's case was wrongfully excluded by Court of Appeals. This is a reversible error because it caused Appellant significant harm and the admission of such evidence would have greatly weakened the arguments of Appellee concerning Appellant's legal argument, as well as forced the Appellee to directly engage the actual substance of the Appellant's argument, address the legal merits thereof, and prove that his argument for redress was in fact being heard.

III. THE COURT OF APPEALS ERRED IN FINDING THAT APPELLANT'S ARGUMENT IS FRIVOLOUS, BECAUSE THE ISSUES RAISED IN THIS APPEAL HAVE NOT BEEN DECIDED IN ANY PREVIOUS CASES AND BECAUSE THE IRS HAS ACCEPTED THIS SAME ARGUMENT AS PRESENTED IN APPELLANT'S YEAR 2000 TAX RETURN AND ISSUED A CREDIT TO APPELLANT FOR THE FULL AMOUNT REQUESTED

26 U.S.C. §6673(a)(1) provides a Tax Court judge with discretion to impose a penalty not in excess of $25,000 if any of three findings are made: "(A) proceedings before it have been instituted or maintained by the taxpayer primarily for delay, (B) the taxpayer's position in such proceeding is frivolous or groundless, or (C) the taxpayer unreasonably failed to pursue available administrative

remedies." Appellee claims that both (A) and (B) apply to Appellant, and argues in the alternative since only one of the three findings is required by the Tax Court for an imposition of penalty.

Not only has Appellant demonstrated through clear reasoning that his argument is not frivolous (lacking basis of law), but the IRS has effectively accepted this argument by accepting his year 2000 tax return as correct and valid and issuing a credit to Appellant for the full amount requested. Even though the amount of total tax that was paid and then refunded was only $398.19, the fact that this paltry sum is dwarfed by the amounts in question in this case is completely irrelevant. By accepting the year 2000 return as correct and valid, Appellee admits by its own actions that this argument is not frivolous. Combining this fact with Appellee's failure to present any on-point case law supporting its claims, Appellee's claims and position regarding parameter (B) is lacking both in legal and factual merit.

Also, Appellant's successful use of this argument on his 2000 return is clear and convincing evidence that Appellant did not institute this proceeding primarily for delay but had a reasonable expectation of winning the case. As the legal issues presented here are a matter of first impression, Appellant reasonably concluded that an unfavorable ruling by the Tax Court on the law was subject to de novo review by the Court of Appeals and the Supreme Court.

Appellee argues that Appellant's motives for delay are evident in his statement during the pre-trial conference call that "with all the money at stake, it really didn't matter." However, this one statement by Appellant, uttered in the face of a threat of sanction against him for his pursuit of his right to due process of law, cannot be taken out of the full context of the novel argument he was presenting to the Tax Court.

Furthermore, Appellee argues that Appellant never had any intention of introducing evidence; however, Appellant's attempts to introduce testimony by cross-examining government witnesses were improperly curtailed by the Tax Court.

Appellee further discussed issues that occurred in the criminal trial that are irrelevant and prejudicial to this proceeding. For example, Appellee states that Appellant's attempts to quash a summons proves that Appellant is trying to subvert the law. In raising this point Appellee not only failed to see the irrelevancy of such discussion and restrain itself but also failed to acknowledge that Appellant has the right to file motions to quash a summons without such an act constituting a subversion of law, as such process is provided for on Part D of IRS Form 2039 which accompanies all IRS Summons forms.

Appellee has offered no useful rebuttal to Appellant's argument that the Tax Court's imposition of a $25,000 penalty constituted an abuse of discretion. Since Appellant's case does not meet any of the standards for imposing penalties under §6673, the penalty should be reversed as an abuse of discretion.

CONCLUSION

This case presents novel issues that have been neither addressed nor decided in the federal courts. Appellee's insincere attempts to paint this argument as frivolous contradict the IRS' determination that Appellant's year 2000 tax return is correct and valid even though his legal position on that return is exactly the same as the position presented to the Tax Court and on appeal to this Court. On the other hand, Appellee has presented frivolous arguments to the Court of Appeals, such as presenting off-point and irrelevant case citations, arguing that Section 1 of the Internal Revenue Code imposes a tax on

"income" instead of on "taxable income," and arguing that Section 61 is the only section of law that applies to determining gross income in the face of clear rulings by the High Court that Section 61 is subject to all statutory precursors. In light of the above, Appellant received a ruling from the Court of Appeals that neither addressed any of his relevant and novel legal arguments of law nor considered highly relevant factual evidence which would have greatly damaged Appellee's arguments before the Courts.

For the reasons cited herein, Appellant prays this Court to GRANT A WRIT OF CERTIORARI and hear this case, and REVERSE the order of the United States Court of Appeals for the Eighth Circuit affirming the Tax Court's ruling with regard to the deficiency of tax and the penalty imposed under §6673, and REMAND this case to the Tax Court for a new trial on the merits, or whatever relief this Court deems appropriate.

Submitted faithfully to the Supreme Court of the United States this 23rd day of April, 2002:

Darlow Thomas Madge

Darlow Thomas Madge

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United States Court of Appeals
FOR THE EIGHTH CIRCUIT

No. 01-1531

Darlow T. Madge,	*	
	*	
Appellant,	*	
	*	Appeal from the
v.	*	United States
	*	Tax Court.
Commissioner of Internal Revenue,	*	[UNPUBLISHED]
	*	
Appellee.	*	

Submitted: November 6, 2001
Filed: November 14, 2001

Before WOLLMAN, Chief Judge, BOWMAN, and LOKEN, Circuit Judges

PER CURIAM.

The Commissioner of Internal Revenue issued deficiencies, additions to tax, and penalties against Darlow T. Madge after he failed to file tax returns for the years 1987-1993. Madge petitioned for review, and the Tax Court (Foot Note 1) upheld the amounts and sanctioned Madge for pursuing frivolous arguments. Madge appeals, arguing that income he received from his business was not "gross income" under the tax code, he was denied due process, and the sanction was inappropriate. After careful review of the record, we affirm.

Foot Note 1: The HONORABLE MARY ANN COHEN, Chief Judge, United States Tax Court.

Madge, who elected not to introduce any evidence, failed to meet his burden of proving that the Commissioner's deficiency determination was incorrect, see Mattingly v. United States, 924 F.2nd 785, 787 (8th Cir. 1991, and the Tax Court properly rejected Madge's contention that the income from his business was not "gross income" under 26 U.S.C. Section 61(a).

Based on the undisputed evidence at trial-- which show, among other things, that Madge used false identification for some bank accounts and threatened cooperating witnesses -- we conclude the Commissioner proved fraud by clear and convincing evidence. See Scallen v. Comm'r, 877 F.2d 1364, 1370 (8th Cir. 1989). Finally, the Tax Court did not abuse its discretion by sanctioning Madge for insisting upon pursuing frivolous arguments after the Court repeatedly warned him not to do so. See 26 U.S.C. Section 6673; Hammers v. Comm'r, 894 F. 2d 282, 283 (8th Cir. 1990).

Accordingly, we affirm. We also deny Madge's motions for oral argument and to take notice of his recent tax return.

A true copy.

Attest:

CLERK, U.S. COURT OF APPEALS, EIGHTH CIRCUIT

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 01-1531

Darlow T. Madge,	*	
	*	
Appellant,	*	
	*	Order Denying
v.	*	Petition for
Rehearing		
	*	and for Rehearing
Commissioner of Internal Revenue,	*	En Banc
	*	
Appellee.	*	

The petition for rehearing en banc is denied. The petition for rehearing by the panel is also denied.

(5128-010199)

January 23, 2002

Order Entered at the Direction of the Court:

Signature of Michael E. Gans

Clerk, U.S. Court of Appeals, Eighth Circuit

App. 4

T.C. Memo. 2000-370

UNITED STATES TAX COURT

DARLOW T. MADGE, Petitioner v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 10504-99. Filed December 7, 2000.

Darlow T. Madge, pro se.

Denise G. Dengler, for respondent

MEMORANDUM OPINION

Cohen, Judge: Respondent determined deficiencies, additions to tax, and penalties with respect to petitioner's Federal income tax as follows:

		Additions to Tax and Penalties		
Year	Deficiency	Sec. 6651(f)	Sec. 6653(b) (1) (A)	Sec. 6654
1987	$59,607	-0-	$44,705.79	$3,199.79
1988	57,101	-0-	42,825.75	3,672.94
1989	70,534	$52,900.50	-0-	4,770.17
1990	68,450	51,337.50	-0-	4,481.53
1991	74,079	55,559.25	-0-	4,233.69
1992	88,708	66,531.00	-0-	3,869.04
1993	69,563	52,172.25	-0-	2,914.65

Respondent also determined an addition to tax under section 6653(b) (1) (B) for 1987. Unless otherwise indicated, all section references are to the Internal Revenue Code in effect for the years in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure.

Throughout these proceedings, petitioner has maintained only frivolous positions. To the extent that his voluminous submissions are intelligible, he contends that he is not a taxpayer, that his income from sale of hospital supplies is not an item of income taxable under section 61, and that the regulations promulgated under section 61 provide that only foreign income is taxable. Petitioner has maintained these positions despite having been convicted of tax evasion under section 7201 for 1990, 1991, 1992, and 1993 and of conspiracy to obstruct and impede the Internal Revenue Service (IRS) under 18 U.S.C. sec. 371.

Petitioner failed to present any evidence that the amounts of income and deductions determined in the statutory notice are erroneous. He argues merely that he has been denied due process because he was not permitted at the administrative level to argue his theories that his income is not taxable. By reason of his failure to present evidence, all issues other than the additions to tax for fraud under section 6653 (b) and the penalties for fraudulent failure to file returns under section 6651 (f), as to which respondent has the burden of proof, are decided against petitioner. See Rules 123, 142(a), 149(b).

Background

Some of the facts have been stipulated, and the stipulated facts are incorporated in our findings by this reference. At the time the petition was filed, petitioner resided at the Federal Prison Camp at Duluth, Minnesota.

Prior to and during the years in issue, petitioner operated a hospital supply business known as Allied Medical Associates (Allied). The business was operated out of petitioner's residence. For the years in issue, Allied received income from sales in the following amounts:

Year	Amount Received
1987	385,291.83
1988	472,287.70
1989	541,307.68
1990	557,189.48
1991	469,659.69
1992	464,070.32
1993	442,100.83

Petitioner maintained at various locations various bank accounts into which his business receipts were deposited. Some of the accounts were maintained at banks in communities distant from petitioner's residence. Petitioner used false Federal identification numbers on some of those bank accounts. Petitioner did not file income tax returns for any of the years in issue because he decided that the moneys that he received were not gross income as defined by the applicable statutes and regulations. In April 1992, petitioner purported to revoke his Social Security number.

On or about September 27, 1989, petitioner completed a residential loan application. On that application, he represented that his employer was Allied, that he had been employed on that job for 10 years, and that his base employment income was $15,000 per month. On or about May 6, 1993, petitioner executed a uniform residential loan application on which he represented that his employer was Allied, that he had been 14 years on the job, and that his base employment income was $20,000 per month.

In approximately January 1994, the IRS commenced an investigation of petitioner. Petitioner did not cooperate with the investigation and, instead, sought to obstruct the investigation. In

March 1994, IRS officers and other law enforcement officials executed a search warrant at petitioner's residence. Among items seized at the residence were "accounts receivable" records, "accounts payable" records, bank records, and signed but unfilled tax returns for petitioner for 1981 and 1982. The accounts receivable and accounts payable records reflected cash receipts and expenditures. On or about February 1997, petitioner and others were indicted by a Grand Jury for the U.S. District Court for the District of Minnesota. The indictment charged petitioner with conspiracy to obstruct and impede the due administration of the Internal Revenue Code and with tax evasion under section 7201 for 1990 through 1993. On September 2, 1998, petitioner was convicted of the charges, was sentenced to prison for a term of 41 months, and was ordered to make restitution and pay other amounts to the United States.

Using the records seized at petitioner's residence, respondent calculated the sales of Allied during the years in issue as set forth above, determined that petitioner had other unreported income, and allowed petitioner deductions for expenses appearing in the accounts payable records.

Discussion

For 1987, section 6653 (b) (1) provides in pertinent part:

(1.) In general.-If any part of any underpayment (as defined in subsection (c) of tax required to be shown on a return is due to fraud, there shall be added to the tax an amount equal to the sum of-

A. 75 percent of the portion of the underpayment which is attributable to fraud, and

B. an amount equal to 50 percent of the interest payable under section 6601 with respect to such portion for the period

beginning on the last day prescribed by law for payment of such underpayment (determined without regard to any extension) and ending on the date of the assessment of the tax or, if earlier, the date of the payment of the tax.

For 1988, the applicable provision was in essence the same as the above section 6653 (b) (1) (A). For 1989 through 1993, section 6651 provides in pertinent part:

SEC. 6651. FAILURE TO FILE TAX RETURN OR TO PAY TAX.

(a.) Addition of Tax.-In case of failure-

(1) to file any return required under authority of subchapter A of chapter 61 (other than part III thereof), subchapter A of chapter 51 (relating to distilled spirits, wines, and beer), or of subchapter A of chapter 52 (relating to tobacco, cigars, cigarettes, and cigarette papers and tubes) or of subchapter A of chapter 53 (relating to machine guns and certain other firearms), on the date prescribed therefore (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the amount required to be shown as tax on such return 5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate;

* * * * * * *

(f) Increase in Penalty for Fraudulent Failure to File.-If any failure to file any return is fraudulent, paragraph (1) of subsection (a) shall be applied-

(1) by substituting "15 percent" for "5 percent" each place it appears, and

(2) by substituting "75 percent for "25 percent".

Respondent has the burden of proving fraud. See Sec. 7454 (a). In considering the additions to tax or penalties for fraud, we consider the same elements under former section 6653 (b) (1) and under section 6651 (f). See Clayton v. Commissioner, 102 T.C. 632, 653 (1994).

Respondent has proven unreported income from petitioner's business and has allowed deductions that respondent could identify. Petitioner has failed to present any evidence of additional deductions that would offset his income. See United States v. Shavin, 320 F.2d 308, 310-311 (7th Cir. 1963); Elwert v. United States, 231 F.2d 928, 933-936 (9th Cir. 1956); Greenwood v. Commissioner, T.C. Memo. 1990-362.

The existence of fraud is a question of fact to be resolved upon consideration of the entire record. See Gajewski v. Commissioner, 67 T.C. 181, 199, (1976), affd. Without published opinion 578 F.2d 1383 (8th Cir. 1978). Fraud may be proved by circumstantial evidence because direct proof of the taxpayer's intent is rarely available. The taxpayer's entire course of conduct may establish the requisite fraudulent intent. See Stone v. Commissioner, 56 T.C. 213, 223-224 (1971); Otsuki v. Commissioner, 53 T.C. 96, 105-106 (1969).

Over the years, courts have developed various factors, referred to as badges of fraud, that tend to establish fraud. See Recklitis v. Commissioner, 91 T.C. 874, 910 (1988). Those badges include a pattern of understatement of income, failure to file tax returns, implausible or inconsistent explanations of behavior, concealing assets, and failure to cooperate with tax authorities. See, e.g., Bradford v. Commissioner, 796 F.2d 303, 307-308 (9th Cir. 1986, affg. T.C. memo. 1984-601. Each of those badges is present in this case. Petitioner's use of false Federal identification numbers to conceal bank accounts and failure to make estimated tax payments are further evidence of his intent to conceal income and prevent the collection of tax. See Rowlee v. Commissioner, 80 T.C. 1111, 1123 (1983); Leggett v. Commissioner, T.C. Memo. 1999-100, affd. 221 F.3d 1357 (11th Cir. 2000). We conclude that respondent has proven fraud for each year by clear and convincing evidence.

It is well settled that a conviction under section 7201 collaterally estops a taxpayer from denying fraud for purposes of former section 6653 (b). See Blohm v. Commissioner, 994 F.2d 1542, 1554 (11th Cir. 1993), affg. T.C. memo. 1991-636; Amos v. Commissioner, 43 T.C. 50, 54-56 (1964), affd. 360 F.2d 358 (4th Cir. 1965). In view of the substantive identity between the elements considered under section 6653 (b) (1) and section 6651 (f), petitioner's conviction under section 7201 for the years 1990 through 1993 collaterally estops him from denying fraud for those years for purposes of section 6651 (f). See Clayton v. Commissioner, supra; Wallace v. Commissioner, T.C. memo. 2000-49.

Petitioner argues that he has been denied due process because he was not allowed to argue with respondent's agents at the administrative level or during their testimony in court about his

interpretation of the meaning of the Internal Revenue Code and the regulations adopted under it. It is apparent that an administrative hearing in this case would have been futile. Neither his criminal conviction nor the Court's rulings in this case (which he characterized ad "ridiculous") have affected his positions. His positions were certainly not going to be accepted by the IRS.

Petitioner tried prior to and during the trial to withdraw his petition. He was advised that he could not do so. See sec. 7459 (d); Estate of Ming v. Commissioner, 62 T.C. 519, 524 (1974. He requested that the Judge recuse herself for bias because she advised him in a telephone conference call that he would lose his argument that he had no income. That warning to petitioner was made in the context of notice to him about the provisions of section 6673, discussed further below. The Court never indicated any prejudgment on issues of fact, and advising petitioner of the applicable law is not an indication of disqualifying bias. See, e.g.; United States v. Anderson, 433 F.2d 856-860 (8th Cir. 1970); Rowlee v. Commissioner, supra at 1117 n.4.

Petitioner was warned before and during trial about the likelihood that a penalty would be awarded to the United States if he continued to pursue his groundless and frivolous arguments. See sec. 6673. His response was that "with all the money at stake, it didn't really matter." The large deficiencies, additions to tax, and penalties owed by petitioner resulted from his fraudulent failure to file returns. They are not a reason not to impose a penalty under section 6673 for his maintenance of frivolous positions in this case. Considering the entire record, a penalty should be imposed and will be awarded to the United States in the amount of $25,000. See, e.g., Kowalik v. Commissioner, T.C. Memo. 1990-363.

UNITED STATES TAX COURT

WASHINGTON, DC 20217

DARLOW T. MADGE, Petitioner,	)	
v.	)	Docket No. 10504-99
COMMISSIONER OF INTERNAL REVENUE, Respondent.	)	

DECISION

Pursuant to the determination of the Court as set forth in its Memorandum Opinion (T.C. Memo. 2000-370), filed December 7, 2000, it is hereby

ORDERED and DECIDED: That there are deficiencies, additions to tax, and penalties due from petitioner with respect to petitioner's Federal income tax as follows:

		Additions to Tax and Penalties, I.R.C.		
Year	Deficiency	Sec. 6651(f)	Sec. 6653 (b) (1) (A)	Sec. 6654
1987	$59,607	-0-	$44,705.79*	$3,199.79
1988	57,101	-0-	42,825.75	3,672.94
1989	70,534	$52,900.50	-0-	4,770.17
1990	68,450	51,337.50	-0-	4,481.53
1991	74,079	55,559.25	-0-	4,233.69
1992	88,708	66,531.00	-0-	3,869.04
1993	69,563	52,172.25	-0-	2,914.65

* Plus 50% of the interest due on $44,705.79 under sec. 6653 (b) (1) (B), I.R.C.

That petitioner shall pay to the United States a penalty under section 6673, I.R.C., in the amount of $25,000.

Mary Ann Cohen
Judge

Entered: DEC 11 2000